

Message Text

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DRAFTED BY EA/IMS:ADORNHEIM:LMG
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FM SECSTATE WASHDC
TO AMEMBASSY JAKARTA

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TAGS:ENRG, EFIN, ID

SUBJECT: IRS ELABORATION OF ITS RULING ON FOREIGN TAX
CREDITS

1. IRS NEWS RELEASE OF JULY 14 ELABORATES ON REVENUE
RULING 76-215 (STATE 111138) EXTENDING LATTER'S SCOPE TO
ENCOMPASS ALL U.S. TAXPAYERS ENGAGED IN EXTRACTING MIN-
ERAL RESOURCES OWNED BY FOREIGN GOVERNMENTS AND PROVIDING
GENERAL GUIDELINES ON CIRCUMSTANCES UNDER WHICH A FOREIGN
TAX CREDIT WOULD BE ALLOWED AGAINST U.S. INCOME TAX UNDER
SECTION 901 OF INTERNAL REVENUE CODE. GENERAL IRS POLICY
IS THAT A FOREIGN TAX WILL NOT BE RECOGNIZED AS A TAX
FOR US FEDERAL INCOME TAX CREDIT PURPOSES UNLESS FOREIGN
GOVERNMENT CONCERNED ALSO REQUIRES PAYMENT OF AN APPROP-
RIATE ROYALTY OR OTHER CONSIDERATION FOR MINERAL RESOURCES
EXPLOITED BY U.S. COMPANY WHICH IS COMMENSURATE WITH
VALUE OF CONCESSION.

2. PAYMENTS TO A FOREIGN GOVERNMENT WILL BE TREATED AS A
CREDITABLE INCOME TAX IF ALL OF FOLLOWING CHARACTERISTICS
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ARE PRESENT:

A) AMOUNT OF INCOME TAX MUST BE CALCULATED SEPARATELY AND INDEPENDENTLY OF AMOUNT OF ROYALTY AND OF ANY OTHER TAX OR CHARGE IMPOSED BY FOREIGN GOVERNMENT.

B) UNDER FOREIGN LAW AND IN ITS ACTUAL ADMINISTRATION, INCOME TAX MUST BE IMPOSED ON THE RECEIPT OF INCOME BY TAXPAYER, AND SUCH INCOME MUST BE DETERMINED ON BASIS OF ARM'S LENGTH AMOUNTS. THESE RECEIPTS MUST BE ACTUALLY REALIZED IN MANNER CONSISTENT WITH U.S. INCOME TAXATION PRINCIPLES.

C) TAXPAYER'S INCOME TAX LIABILITY CANNOT BE DISCHARGED FROM PROPERTY OWNED BY FOREIGN GOVERNMENT.

D) FOREIGN INCOME TAX LIABILITY, IF ANY MUST BE COMPUTED ON BASIS OF TAXPAYER'S ENTIRE EXTRACTIVE OPERATIONS WITHIN FOREIGN COUNTRY.

E) WHILE FOREIGN TAX BASE NEED NOT BE IDENTICAL OR NEARLY IDENTICAL TO U.S. TAX BASE, TAXPAYER, IN COMPUTING INCOME SUBJECT TO FOREIGN INCOME TAX, MUST BE ALLOWED TO DEDUCT, WITHOUT LIMITATION, SIGNIFICANT EXPENSES PAID OR INCURRED BY TAXPAYER. REASONABLE LIMITATIONS ON RECOVERY OF CAPITAL EXPENDITURES WILL BE ACCEPTABLE.

3. IT IS NOT INTENT OF IRS NEWS RELEASE TO STATE ANY POSITION WITH RESPECT TO WHAT TAXES MIGHT CONSTITUTE "IN LIEU OF" TAXES UNDER SECTION 903 OF IR CODE.

4. PRELIMINARY CHECK WITH LAWYERS FOR GOI (ROGERS AND WELLS) AND FOR NATOMAS DISCLOSED GENERAL SATISFACTION WITH LATEST IRS RULING, TEMPERED BY UNCERTAINTY OVER RESOLUTION OF SOME DETAILS. IRS COMMENDED FOR MOVING PROMPTLY TO CLARIFY AN IMPORTANT PART OF ITS REGULATIONS. ROGERS AND WELLS ATTORNEY THOUGHT APPROACH HIS FIRM WAS GOING TO RECOMMEND TO GOI FOR RESOLUTION OF TAX CREDIT PROBLEM COULD BE "BLENDED IN" WITH NEW IRS GUIDELINES. NATOMAS LAWYER WAS TROUBLED BY GUIDELINE 2D ABOVE, BECAUSE IN INDONESIA AN OIL COMPANY'S TAX LIABILITY IS LIMITED OFFICIAL USE

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COMPUTED ON CONTRACT BY CONTRACT BASIS. NATOMAS COUNSEL THOUGHT TEST CASE MIGHT BE PLACED BEFORE IRS IN PERHAPS A MONTH.

5. OIL COMPANIES MAY ALSO WELCOME IRS GUIDELINES AS THEY COME TO REALIZE INCREASINGLY DOUBTFUL PASSAGE THIS YEAR OF TAX REFORM BILL WITH ITS POTENTIAL PROVISION FOR A DELAY IN EFFECT OF IRS RULING 76-215.

6. COPY OF NEWS RELEASE BEING POUCHED. KISSINGER

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